United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-7538

United States Court of Appeals

For the Second Circuit

B

P/S

Alan L. Spielman,

Plaintiff-Appellant,

against

General Host Corporation, Richard C. Pistell, Harris J. Ashton, C. Whitcomb Alden, Jr., Joseph P. Binns, William F. Downey, Weston E. Hamilton, William P. Howe, Jr., J. Elroy McCaw, Edwin C. McDonald, Leslie W. Scott, Allen & Company, Incorporated, Allen & Company, Kleiner, Bell & Company, Incorporated, Seymour M. Lazar, Eugene V. Klein, Allen Manus, Cecil Manus, and Great American Insurance Company,

Defendants,

General Host Corporation, Richard C. Pistell, Harris J. Ashton, C. Whitcomb Alden, Jr., Joseph P. Binns, Weston E. Hamilton, Leslie W. Scott, Allen & Company, Incorporated, and Allen & Company,

Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

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BRIEF FOR PLAINTIFF-APPELLANT

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UNITED STATES COURT OF APPEALS

For the Second Circuit

Docket No. 75-7538

ALAN L. SPIELMAN,

Plaintiff-Appellant,

- against -

GENERAL HOST CORPORATION, RICHARD C. PISTELL, HARRIS J. ASHTON, C. WHITCOMB ALDEN, JR., JOSEPH P. BINNS, WILLIAM F. DOWNEY, WESTON E. HAMILTON, WILLIAM P. HOWE, JR., J. ELROY McCAW, EDWIN C. McDONALD, LESLIE W. SCOTT, ALLEN & COMPANY, INCORPORATED, ALLEN & COMPANY, KLEINER, BELL & COMPANY, INCORPORATED, SEYMOUR M. LAZAR, EUGENE V. KLEIN, ALLEN MANUS, CECIL MANUS, and GREAT AMERICAN INSURANCE COMPANY,

Defendants,

GENERAL HOST CORPORATION, RICHARD C. PISTELL, HARRIS J. ASHTON, C. WHITCOMB ALDEN, JR., JOSEPH P. BINNS, WESTON E. HAMILTON, LESLIE W. SCOTT, ALLEN & COMPANY, INCORPORATED, and ALLEN & COMPANY,

Defendants-Appellees.

BRIEF FOR PLAINTIFF-APPELLANT

PRELIMINARY STATEMENT

Plaintiff-Appellant, Alan L. Spielman brought this action individually and on behalf of a class consisting of holders of common stock and convertible debentures of Armour & Company ("Armour") who tendered such securities to General Host Corporation ("Host") for Host debentures and warrants, pursuant to an

Exchange Offer Prospectus ("Prospectus") which plaintiff claims was materially false and misleading. The action was brought to recover damages sustained as a result thereof against Host, certain of its officers and directors and co-dealer-managers deemed underwriters. Plaintiff-appellant appeals from a final judgment, rendered after a non-jury trial, on liability only, before the United States District Court of the Southern District of New York (the Honorable Edward Weinfeld, presiding) which dismissed the claims of plaintiff-appellant and the entire class which he represents on the merits and granted judgment to the defendants-appellees. The Opinion of the Court is reported at CCH Federal Securities Law Reporter, ¶95,267 (Current Volume) and is set forth at pages 699 through 749 of the Joint Appendix.

ISSUES PRESENTED

1. Did the District Court err in failing to find that the Host Prospectus pursuant to which Host tendered its debentures and warrants for Armour securities was materially misleading with respect to the ability of Host to control Armour ("Control Problem") in that:

(a) the Prospectus implied falsely that Host, upon obtaining more than 50% of the common stock of Armour, would have operating control of Armour;

(b) the Prospectus failed to set forth the serious impediments to Host's ability to obtain operating control of Armour;

(c) the Prospectus represented that Host could take certain courses of action with respect to Armour and its assets, without setting forth the known conditions and risks which could prevent Host from so doing; and

(d) the inclusion of consolidated pro forma financial statements of Host and Armour in the Prospectus gav[illegible] false impression that Host would have operating control of Armour, because that is the fundamental assumption and basis upon which consolidated statements are presented?

2. Did the District Court err in failing to find that the Prospectus was materially misleading with respect to Host's ability to pay the interest on the Debentures and otherwise satisfy its needs for operating capital (the "Cash Flow Problem") in that;

(a) the Prospectus failed to disclose that Host was relying upon projections to meet its future debt and debt service obligations;

(b) the Prospectus failed to disclose that Host could not meet its future debt and debt service obligations out of internally generated funds; and

(c) the Prospectus represented that upon consummation of the Exchange Offer, without more, Host would be able to control Armour's dividend policy and dispose of Armour's assets?

3. Did the District Court err in concluding that even if the Prospectus was materially misleading as to the Control Problem and the Cash Flow Problem, said deficiencies were rendered harmless by statements found in the Annex to the Prospectus and statements disseminated by others?

4. Did the District Court err in dismissing the complaint against Allen & Company?

STATEMENT OF THE CASE

This is an appeal by plaintiff from a judgment for defendants entered on August 27, 1975 in the United States District Court for the Southern District of New York after a non-jury trial before Judge Weinfeld.[1/] The action, commenced on February 6, 1973, was brought, insofar as pertinent to this appeal, on behalf of those security holders of Armour who exchanged their Armour securities for debentures and warrants of Host pursuant to the Prospectus declared effective January 30, 1969.[2/] The action was tried against Host; certain of its officers and directors, including Richard C.Pistell, Chairman of the Board, and Harris J. Ashton ("Ashton"), president and a director of Host and a member of the law firm of Lovejoy, Wasson,Lundgren & Ashton (counsel for Host on

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1/ The trial was limited to the issue of liability.
2/ The action was certified as a class action and notice duly given to the class members.

the Prospectus and in the trial of this action); Allen & Company, Incorporated ("Allen, Inc."), co-dealer manager of the Exchange Offer and Allen & Company ("Allen Co."), an affiliate of Allen, Inc., which plaintiff contended controlled, aided and abetted, and was an "alter ego" of Allen, Inc.

Plaintiff alleged that the Prospectus was materially false and misleading in violation of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(b) and 78n(e); Rule 10b-5, 17 C.F.R. Section 240.10 b-5; and Section 17(a) of the Securities Act of 1933, 15 U.S.C. Section 17q. At trial, on the issue of liability only, plaintiff's claims were narrowed to the adequacy of disclosure with respect to Host's ability to obtain operating control of Armour and Host's cash-flow problems, both of which vitally affected the value of Host's securities offered in the exchange. The District Court held that the Prospectus was not materially misleading, but, even if it was, any defects were cured by other materials published or disseminated outside the Prospectus by Host and Armour.[3/] The District Court's decision was based on stipulated or uncontested facts.

In May, 1973, the Securities and Exchange Commission ("the SEC") had instituted a related action, Securities Exchange Commission v. General Host Corporation, et al., (S.D.N.Y.73 Civ. 275),

3/ The case was dismissed against Allen & Co. at the conclusion of the trial on the ground that it was not liable for issuance of the Prospectus.

seeking injunctive relief an disgorgement against the defendants here and others, .lleging, inter alia, that the Prospectus was materially false and misleading. That action was also assigned to Judge Weinfeld. It was termianted by consent decrees, including creation of a $300,000 fund to be paid by Allen, Inc., for the benefit of the Armour security holders who made the exchange.

In an earlier related action, Armour & Company and McClure Kelley v. General Host Corporation, et al., (S.D.N.Y. 69 Civ. 279), filed on January 23, 1969, Judge Weinfeld denied plaintiffs' application for a preliminary injunction, seeking to enjoin the Host Exchange Offer.[4/] When that action was commenced only a preliminary prospectus had been produced. It did not contain the language in the final Prospectus central to the issues here. Moreover, Judge Weinfeld recognized at the trial of this case that control was not an issue before him in the Armour case. (JA 34).[5/, 6/]

4/ Armour & Co. v. General Host Corp., 296 F. Supp.470 (S.D.N.Y. 1969).

5/ In any event, denial of a preliminary injunction, even if it were in the same case, would not carry any weight at the final hearing on the merits. The Armour case was dismissed on stipulation of the parties, approved by the District Court, despite the fact (i) that it was, in part, a class action on behalf of Armour's shareholders, (ii) that no determination was made that it was not a proper class action, and (iii) that no notice of the dismissal was given to the class pursuant to F.R.C.P. 23(e).

This action was subsequently terminated by consent of the parties.

6/ References are to the Joi : Appendix.

STATEMENT OF FACTS

Synopsis of Events

This action arises out of the attempted takeover of Armour by Host in February, 1969. Host, a company with sales and assets approximately one-fourth of those of Armour, sought to gain control of Armour by acquiring Armour securities in a registered exchange offer (the "Exchange Offer") in which Host offered to exchange its newly created 7% debentures (the "Debentures") and common stock purchase warrants (the "Warrants") for Armour common stock and convertible debentures. Although Host was opposed by the Armour management and faced with a competing cash tender offer by a subsidiary of the Greyhound Corporation ("Greyhound"), Host, nevertheless, acquired approximately 55% of Armour, with Greyhound acquiring approximately 32%.

The attractiveness of the Host offer, in view of Greyhound's cash tender offer, was predicated upon Host's obtaining operating control of Armour. Host needed the Armour assets to support the large amount of debt it proposed to issue in the Exchange Offer and needed the Armour cash flow to help it pay the interest on that debt. Without that control, the Host Debentures would be backed only by Host's relatively meager operating assets and its interest in Armour's securities, an asset whose saleability at an adequate price would be in jeopardy. Similarly, without control of Armour, Host's

cash flow would not include the Armour earnings, but only the dividends, if any, that might be paid on the Armour stock owned by Host. 7/

Host, however, was not able to obtain operating control of Armour because of several foresceable factors, including the staggered board and cumulative voting provisions of the Armour by-laws, the continued opposition of Greyhound and the Armour management, and Host's own overextended credit. The Armour by-law provisions limited Host to electing but 4 of 17 of the Armour directors at the 1969 annual meeting, thereby providing the Armour management and Greyhound with additional time to fortify their controlling position. Moreover, the differential in the funds available to Greyhound and Armour, on the one hand, and Host, on the other hand, placed Host at an extreme disadvantage in a protracted battle for operating control.

Host's inability to obtain operating control of Armour, and the importance of that fact, was confirmed by Allen. Inc. when it recommended that Host sell its Armour holdings to Greyhound within only a few months following the Exchange Offer. This sale resulted in a loss to Host of approximately $51 million, which in turn caused a catastrophic drop in the market price of the Host Debentures and Warrants issued to the former Armour security holders in the Exchange Offer.

The risk that Host would not be able to obtain operating control of Armour, although fully foreseen by the defendants, was nowhere disclosed in the Prospectus. On the contrary, the Host Prospectus gave the false impression that Host would

7/ Host had been attacking the manner in which Armour had been managed and, in effect, was requesting Armour security holders to give Host's management the chance to demonstrate their ability to improve Armour's performance.

be able to take certain actions which were predicated upon Host's obtaining operating control without disclosing that there were serious obstacles to its obtaining such control. Nor did the Prospectus give warning that Host was relying upon projections to meet its future debt and debt service obligations.

<u>Background of the Exchange Offer</u>

Between August and November 1968, Host acquired 1,002,500 shares of Armour common stock, representing approximately 16-1/2% of Armour's then outstanding shares (JA.655) (Stip.25). 8/ In consideration for these shares, Host paid an aggregate purchase price of $59,381,830, plus a warrant to purchase 175,000 shares of Host common stock. (JA.827) (Pros.p.8). 9/ In order to make these purchases, Host had borrowed in excess of $60 million (JA.654-655) (Stip.23 and 25), placing an obvious strain on Host's credit. At that time, Host's net worth was only $37.5 million (JA.856) (Pros.p.17).

These initial purchases of Armour stock had been made pursuant to a written master plan developed by Host in October, 1968 (JA 654) (Stip. 25) for the takeover of Armour (the "Master Plan"). This Master Plan (JA 814-819) (PL.Ex.8) 10/ was over 150 pages in length and spelled out a six phase strategy by which Host would take over Armour, merge their companies and integrate their operations.

8/ References to the pretrial stipulations of the parties incorporated in the pretrial order will be noted herein as "Stip." and followed by the appropriate paragraph number in the Pretrial Order.

9/ References to the Prospectus (Plaintiff's Ex.23) will be noted herein as "Pros." and followed by the appropriate page number.

10/ References to Plaintiff's and Defendants' exhibits before the trial court will be noted herein as "Pl.Ex." and "Def.Ex." and followed by the appropriate exhibit number.

Host's purchases of Armour stock during the Fall of 1968 constituted the first three phases of the Master Plan. Phase Four called for an exchange offer designed to lift Host's ownership of Armour to the 40-51% level. The Master Plan envisioned that a 40-51% block would be sufficient to permit Host to merge into Armour, which constituted the fifth phase of the Master Plan. 11/

The Master Plan also contained a chapter (VI) entitled "Legal Implication" in which a number of legal hurdles were discussed. In particular, the Master Plan identified as a serious problem Armour's by-law and charter provisions regarding the election of directors (PL. Ex.8) (JA 815-816):

> "The Board of Directors has seventeen members divided into three classes. Each director has a three year term of office. Six directors come due for election in 1969, five in 1970 and six in 1971. Voting for directors need not be by ballot.
>
> Voting for directors is cumulative pursuant to the Certificate of Incorporation and By-Laws. To determine the minimum number of shares needed to insure a given number of directors the following formula may be used:
>
> $$x = \frac{ac}{b+1} + 1$$
>
> x = minimum number of shares required, assuming that all outstanding shares are voted
> a = total shares
> c = number of directors desired to elect
> b = number of directors to be elected
>
> Assuming all outstanding shares are voted, the following numbers of shares would be needed to elect the following numbers of directors in 1969:

11/ This estimate was made before Greyhound announced its competing tender offer.

Number of Directors	Shares Needed
1	854,259
2	1,728,513
3	2,592,769
4	3,457,024
5	4,321,280
6	5,189,586"

Because of these provisions, Host recognized that there might be difficulties in obtaining control of Armour. Furthermore, these provisions for the election of Armour directors could not be readily circumvented even if Host obtained a majority of the Armour shares, because such changes themselves seemed to require Board approval. Thus, the Master Plan noted (JA 819):

> "Amendment of By-Laws
>
> Section 109 of the Delaware General Corporation Law provides that the power to amend By-Laws shall be in the stockholders; this Section also provides, however, that the corporation may in its Certificate of Incorporation confer that power upon the directors. The Armour Certificate of Incorporation gives that power to the Board of Directors.
>
> It is not clear (a) whether the Armour Certificate of Incorporation could be construed to purport to take all power to amend By-Laws away from stockholders, and (b) whether, if so construed, the Certificate of Incorporation would be in compliance with Delaware Law. Armour may be expected to contend that the By-Laws may be amended only by its directors and not by its stockholders. While the answer to the question is not clear, however, preliminary review indicates that there is a substantial likelihood that action taken by a majority of the stockholders at an annual meeting to amend the By-Laws to, for instance, increase the number of Armour directors would be held to be binding upon the Corporation."

Lastly, the Master Plan pointed out (JA 819) that under Delaware law a merger required the approval of the holders of two-thirds of the outstanding shares and that shareholders did not have the right to initiate a merger or to call a special meeting of shareholders.

In response to the then apparent Host threat, Armour sought to acquire Williams Bros. through the issuance of additional Armour shares, which would have reduced Host's 16 1/2% interest in Armour to a 9% or 10% interest (JA. 232-4).[12/] Glynn, Host's Comptroller, testified that "the proposed merger with Williams Bros. Company was the predominant reason why General Host decided that it had to increase its investment [in Armour]." (JA. 233). Thus, in mid-December, Host decided to proceed with Phase Four and announced its intention to make an exchange offer for Armour stock (JA 657) (Stip. 33 and JA. 393).

The Armour management next sought to involve regulatory agencies. They persuaded the Justice Department to bring an injunctive action against Host on the grounds that its acquisition of the Armour stock would result in an acquisition of operating control and would therefore violate a 1920 antitrust consent decree (the "Packers Decree") to which Armour was subject. This action (the "Antitrust Action") was brought and tried in the United States District Court in Chicago before Judge Hoffman.

12/ This acquisition was subsequently cancelled on December 30, 1968.

Host contested the Antitrust Action as being premature, arguing that Host's ability to gain control of Armour was in substantial doubt. In support of this contention, Host submitted an affidavit of its President, Harris J. Ashton, sworn to on January 23, 1969 (the "Ashton Affidavit"), which enumerated the many obstacles in the way of Host's quest for control of Armour and read in part as follows:

> "7. The Government's application for an order restraining General Host's proposed exchange offer should be denied at this time as premature. The Government alleges that control of Armour by General Host is prohibited by the Packer's Consent Decree and that such control is imminent. In fact, however, control of Armour by General Host is far from imminent and it may never occur. Although General Host is currently Armour's largest stockholder, its present holdings do not give it control of Armour and are sufficient only to enable it to obtain minority representation on Armour's Board of Directors. This point is explained in more detail later in this affidavit.
>
> * * *
>
> 10. Even if General Host acquires a controlling stock interest in Armour through its exchange offer, it does not appear possible under Armour's present Certificate of Incorporation and By-Laws, for General Host to elect a majority of Armour's directors at the 1969 Annual Meeting which is presently scheduled to be held February 21, 1969. It may not be possible for General Host to control Armour by electing a majority of its directors prior to the 1970 Annual Meeting.
>
> * * *
>
> 12. Moreover, only six of Armour's present seventeen directors are standing for election at the forthcoming Annual Meeting. Therefore, even if every presently outstanding share of Armour stock were tendered, it does not appear presently possible for General Host to elect more than six directors out of seventeen in 1969. Of course, it is highly unlikely that all outstanding stock will be tendered. Certainly, General Host has no reason to suppose that Armour's present management will tender its stock. Therefore, realistically, General Host cannot expect to own enough stock to elect more than four

or possibly five directors at the 1969 Annual Meeting, even if General Host obtains valid proxies to vote the stock from all persons who tender to it.

13. Not only may General Host have only a minority position on Armour's Board during 1969 regardless of the extent of its ownership of Armour stock, but in addition, General Host may very well have no representative at all on the Executive Committee of the Board. Armour's By-Laws provide for an Executive Committee which is elected by the directors and which presently consists of eleven of the seventeen directors, including the Chairman and the President. This Executive Committee may exercise most of the powers of the Board of Directors in the management of the business and affairs of Armour, including the hiring and firing of employees. The present management clearly controls the members of the Board and the Executive Committee.

14. So long as the present management retains a majority position on the Board of Directors and the Executive Committee, it can continue to control and operate Armour for a considerable period of time. Thus, even assuming that General Host acquires a majority stock interest in Armour through the exchange offer, it may [not] control Armour for a considerable time."

* * *

22. Reports have reached us from time to time that Armour's present management is very anxious to avoid control by General Host. Since Armour's present management has already sought possible acquisitions in exchange for Armour stock, there is every reason to suppose that they will continue to look for future acquisitions to dilute General Host's interest and perpetuate their own control of Armour. (Emphasis added) (Pl. Ex. 21, pp. 60-68, JA 766-768, 771).

This affidavit, executed only five days before the Exchange Offer, shows that Host understood each and every one of the obstacles to control which it chose to omit from the Prospectus. On the basis of this affidavit, Judge Hoffman on January 21, 1969 denied the Government's petition to enjoin the Host Exchange Offer.

As indicated in paragraph 22 of the Ashton Affidavit, the

vigorous opposition of the Armour management was clear to Host. Glynn testified that he and the other members of the Host management were well aware of the opposition of the Armour mangagement to any involvement by Host in Armour's affairs. (JA. 222) Armour management had refused to meet with representatives of Host to discuss the possibilities of merger or Host's participation on the Armour Board (JA. 655) (Stip. ¶26); and Ashton, Herbert A. Allen (of Allen Co. and Allen Inc.) and Glenn testified (JA. 223, 261 and 417) that Host might have to resort to amending the Armour by-laws and increasing the size of the Armour Board in order to get operating control. Furthermore, Glynn testified that Host felt that Armour's management "was prepared to do anything regardless of whether or not it was detrimental to the interest of all Armour shareholders to dilute the General Host stock position in the Company" (Armour). (JA. 232-3)

The Prospectus

On December 30, 1968 (while the Antitrust Action was pending) (JA. 924-1022) the original version of the Prospectus (Def. Ex.A-18) was filed with the SEC (JA. 658-659) (Stip. 37).

Armour obtained a copy of the preliminary prospectus and complained to the SEC (as well as the various state securities commissions) that the preliminary prospectus failed to adequately disclose (i) the serious antitrust problems posed by the Host Exchange Offer and (ii) the potential Cash Flow Problem which Host might create by issuing the
(JA. 1075 and 1076)
Debentures. (Def. Ex. A-22 and A-23).

Furthermore, on January 9, 1969 and again on February 10, 1969 the Armour management sent letters to the Armour shareholders which were also published in the Wall Street
(JA. 1083, 1084, 1422 and 1439)
Journal. (Def. Ex. A-25, A-26, A-63 and A-65). These letters dealt with the antitrust problem and with the Cash Flow Problem, but not the Control Problem. In fact, they assumed that if Host obtained a majority of the Armour shares, it would control Armour.

On January 21, 1969 (while the SEC was still considering the Host preliminary prospectus), the Armour management received a setback. Judge Hoffman refused to enjoin the Exchange Offer on antitrust grounds. Two days later, Armour commenced its own action, Armour and Company v. General Host Corp., (S.D.N.Y. 69 Civ. 279), seeking to restrain and permanently enjoin the Exchange Offer for
(JA 659)
alleged misrepresentations in the preliminary prospectus (Stip. 39). On January 26, 1969, Judge Weinfeld declined to issue a temporary

restraining order; and on February 7, 1969 Armour's motion for a preliminary injunction was also denied. 13/

In the meantime, on January 27, 1969, Greyhound announced its cash offer for $65 for each share of Armour common stock (JA 660) (Stip. 43). The Greyhound offer was an ominous event to Host. Day, a Host vice president, testified that "when Greyhound entered the picture...we knew - or I believed that that would lessen the possibility of getting a number such as 80%"(JA. 123). 14/ Bettauer of Price Waterhouse & Co. (Host's auditor) testified that he had had conversations with Glynn, Kingsley (Host's Treasurer) and Day from which he had concluded that Host would be in "an untenable position" if it acquired 55 or 57 percent of the Armour stock". (JA. 164). Bettauer had also concluded that "it was apparent that if they (Host) obtained a majority but less than 80%, that they would be headed for a difficult time." (JA. 148).

At about this time, the SEC inquired into whether or not Host had sufficient cash flow "to meet its debt service requirements" (Glynn testimony, JA. 481). In response, and only a few days after Host submitted the Ashton affidavit to Judge Hoffman, Host prepared an amendment to its preliminary prospectus (JA 1329-1405) (Def. Ex. A-46) in which it inserted two additional paragraphs

13/ As noted, at page 6, supra, Judge Weinfeld did not consider that the control question was before him in that proceeding. The proceeding had been commenced before the language on page 9 of the final Prospectus (on which the present action focuses) was inserted.

14/ Host needed 80% of the Armour shares in order to enter into a tax sharing arrangement with Armour, which would greatly augment Host's cash flow.

under the caption "Other Aspects of the Exchange Offer", a section which had previously dealt with certain mechanics of the Exchange Offer, the accounting treatment to be accorded to Host's acquisition of Armour shares, and Host's intended use of proceeds from any exercise of the Warrants. (JA. 465-466) These paragraphs read as follows:

> "General Host intends to act promptly both before and after consummation of the Exchange Offer to obtain control of the board of directors and management of Armour. In this connection it may engage in the solicitation of proxies for the election of directors of Armour and other matters, both at the February 21, 1969 annual meeting of Armour and Company and otherwise.
>
> "General Host may find it desirable upon consummation of the Exchange Offer to propose to stockholders of the relevant corporations a merger or consolidation of it or its present or future subsidiaries with Armour or certain of its subsidiaries, or General Host may find it desirable to dispose of portions of the assets presently held by it or by Armour. If no such merger or consolidation occurs, and if General Host has not acquired more than 80% of Armour's Common Stock, which would allow it to enter into tax-saving arrangements, General Host may find it necessary or desirable to increase the dividend paid on common stock by Armour, or to incur new indebtedness or issue additional equity securities." (Emphasis supplied) (JA. 1339)

Thus, in answer to the SEC's inquiries as to Host's ability to pay the interest on the Debentures, Host had conveyed the impression that Host would be able to satisfy its cash flow requirements out of the Armour assets, implying that it would gain operating control of Armour as a result of the Exchange Offer and that operating control would permit Host to increase Armour's dividends and sell Armour's assets thereby benefiting Host.

Concurrently, a meeting was held with the SEC staff in which Host sought to convince the staff of the adequacy of the new language. To this meeting, Host brought a cash flow analysis for the calendar years 1969 and 1970. Glynn testified that the analysis presented to the staff showed that Host would have a positive cash flow of $5.6 million in 1969 and $2.9 million in 1970, assuming that Host acquired 51% of the Armour stock. (JA. 897)
(Pl. Ex. 24; JA. 481). Glynn also testified "If we (Host) had internal cash flows, which we were relying on that showed a negative cash flow, I presume the SEC would have insisted on some form of disclosure." (JA. 491-492). The cash flow analysis, however, made no provision for capital expenditures which were $8 million and $6 million during the preceding two years. (JA. 241 and 242). Nor did it provide for the repayment of a $9.4 million loan becoming due in August of 1969. (JA. 237). Had these factors been taken into account, the analysis would have revealed a negative cash flow.15/

Furthermore, this analysis had as its basis earnings projections furnished by Host's various operating divisions (JA. 477) which projected a 35% increase for 1970, the first year in which Host was to pay both semi-annual interest payments on the Debentures. Yet it contained no provision for additional working capital that might have been required to achieve a

15/ The District Court stated that this was "obvious" at the trial. (JA. 239). Glynn had testified that had the historical earnings of Host been used the analysis also would have shown that Host could not pay the interest on the Debentures out of internal cash flow (JA. 323-324).

35% increase in earnings.

Based upon the data supplied to it by Host, the SEC declared the Prospectus effective on January 30, 1969 with no additional disclosures regarding the Cash Flow Problem. Thus, the final Prospectus gave the illusion that Host would have no difficulty in servicing the Debentures. The Prospectus also gave no indication that Host might face serious difficulties in obtaining operating control of Armour even if it acquired a majority of the Armour shares. Indeed, there was no mention of the many obstacles to control which Ashton had detailed in his affidavit in the Antitrust Action executed only six days before.[16/] In fact, the only disclosures in the Prospectus which might have indicated the existence of the Control Problem was a reference to Armour's staggered board and cumulative voting provisions found in the back of the Prospectus on pages 8 and 9 of the Annex.[17/]

16/ The Prospectus avoided every opportunity to acknowledge the existence of the Cash Flow Problem and the Control Problem. Even the discussions of the Antitrust Action and the *Armour and Kelley* action on pages 8 and 9 of the Prospectus did not detail the allegations of the complaints but merely stated that injunctive relief had been denied.

17/ The reference to Armour's staggered board and cumulative voting provisions came 44 pages after the relevant language on page 9 of the Prospectus and without benefit of cross-reference or explanation as to its bearing on the Control Problem.

On the contrary, the Prospectus left the dominant impression that if Host acquired a majority of Armour it would achieve operating control of Armour. The newly added language to page 9 of the Prospectus (quoted on p. 18 supra) assumed that Host would have control of Armour. When asked about this language, Glynn testified that "There is a presumption of control in all of these statements there." (JA. 229-230).[18/] Furthermore, the Prospectus contained *pro forma* financial statements consolidating the balance sheets and income statements of Host and Armour. This consolidation depicted Host as owning the Armour assets. Bettauer, Host's auditor, testified that such a consolidation is only appropriate where there is an operating control relationship (JA. 153); and Glynn testified that the SEC requires that "the assumptions upon which the statements are prepared be set forth clearly." (JA. 219). Yet, the Prospectus included the *pro forma* consolidated financial statements which were premised upon the assumption that Host would gain operating control of Armour if it acquired a majority of the Armour stock without disclosing that there was substantial obstacles to that control, thereby rendering the consolidated presentation misleading.

18/ Moreover, because Host, as a majority shareholder of Armour, would be in a fiduciary relationship to the remaining Armour shareholders, it is doubtful that Host would have been legally able to use the Armour assets for its own benefit even if it did obtain operating control.

The Exchange Offer and its Aftermath

Host began distributing the Prospectus on January 31, 1969 in competition with Greyhound's cash tender offer, which had been raised to $72 per share of Armour common stock.

As a result of its Exchange Offer, Host acquired 51% of the Armour common stock plus Armour convertible debentures, which if converted would have increased Host's holdings in Armour to 55% (Stip.49) (JA 661). Greyhound captured 32% of the Armour common stock from its tender offer (Stip.51) (JA 662). 19/ Six Armour board seats became vacant at the annual meeting on February 21, 1969; Host elected four directors and Greyhound elected the remaining two. Thus, Host had won less than 25% of the seats on the Armour Board and control appeared two years away, at best. Although Host proposed a resolution amending the procedure for electing directors, that resolution was declared out of order and Host never took its fight to the courts. Both Day and Ashton testified that Host had hoped that if it acquired more than 50% of the Armour stock, the members of the Armour Board would resign in favor of Host nominees. (JA.107 and 416). This was not to be the case.

As Ashton had predicted in his affidavit in the Antitrust Action, mere ownership of a majority of the Armour shares did not give Host operating control, the power to sell Armour assets, increase Armour dividends or manage Armour. The Armour board still remained in power and in a position to issue additional shares which would erode Host's majority interest. Furthermore, Greyhound had acquired 32% of the Armour stock - providing a base on which to build a new majority.

19/ By January 31, 1969 it was already known to Host that Greyhound had obtained 20% of Armour and that an 8 % consolidation was impossible.

Shortly after the Armour shareholders' meeting, Host tried to ascertain the cost of waging a war of attrition, i.e., maintaining the status quo and hoping that in time it would take over the Armour board. Day testified that at the request of Ashton he prepared an analysis of Host's additional cash requirements under the assumption that it would take two to three years to merge the two companies(JA. 128). This study estimated that Host would need an additional $40 to $50 million to pursue this strategy. (JA. 128). This course of action would not only have been costly but also risky since there was no assurance that Host could ever achieve operating control under the circumstances. Indeed, Allen Inc. in October 1969 pointed to this "continued uncertainty as to control of Armour" as a reason for recommending that Host sell its Armour block. (Pl.Ex. 59). (JA 903-908) 20/

To extricate itself, Host first offered to acquire Greyhound's position, but found the price ($82 per share cash) too high. (JA.436). Ashton testified that Host then tried to borrow $150 million to effect this deal but was turned down by the banks (JA.436). Faced with an intransigent Greyhound, a debt of $9.4 million becoming due within a few months and an eroding credit market, Host, like a victorious Napoleon in Moscow, opted to retreat. 21/ Host, at great expense and risk, had acquired more than 50% of the Armour common stock, but was too small and overextended

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20/This exhibit was admitted only as against Allen Inc.

21/All of these factors had been foreseen by the defendants, but no warning of them was given to the plaintiff class.

to convert that victory into control of this sleeping giant. Consequently, on June 24, 1969, Host announced an agreement in principle to sell its interest in Armour to Greyhound (JA.662) (Stip.53).

Host was now on the run. In the months of negotiation that followed, owing to its extremely vulnerable position, Host yielded further so that the final agreement (executed on October 27, 1969 (JA.662) (Stip.53) provided for a reduced purchase price consisting of approximately $77 million in cash, $36.5 million notes, 800,000 shares of Greyhound $5.00 convertible preferred stock and 4,250,000 warrants to purchase Greyhound common stock (JA. 903). Thus, Host, a company with net assets of approximately $37.5 million came to lose approximately $51 million on its investment in the Armour stock (Pl. Ex.85 p. 16), an investment made with the money of Armour shareholders to whom the loss was passed in the form of reduced prices of the Host Debentures and Warrants. Thus, as in war, the inhabitants of the land on which the generals chose to fight became the principal victims of the battle.

POINT I

The Scope Of Review

The controlling facts on which plaintiff relies are not in dispute, having been either stipulated, or contained in documents, or in uncontroverted testimony. This Court is, therefore, not limited to the "unless clearly erroneous" standard of review. "Any other position would run counter to this court's long held view that application of a legal standard to the facts is not 'a finding of fact.' See Mamiye Bros. v. Barber S.S. Lines, Inc., 360 F. 2d 774, 776-778 (2d Cir.), cert. denied, 385 U.S. 835, 87 S. Ct. 80, 17 L. Ed. 2d 70 (1966), citing many cases; In re Hygrade Envelope Corp., 366 F. 2d 584, 588-589 (2d Cir. 1966) (reasonable cause to believe debtor was insolvent)." Danielson v. Joint Board of Coat, Suit & Allied Garment Workers Union, 494 F.2d 1230, 1244 (2d Cir. 1974).

" ... [W]hen the issue is the application of a legal standard to fact undisputed or reasonably found, reversal is not limited to results that are "clearly erroneous"; it is enough that the appellate court should be convinced, as we are here, that the result does not jibe with the applicable rule of law." In re Hygrade Envelope Corp., 366 F.2d 584, 588 (2d Cir. 1966). See also, Republic Technology Fund, Inc. v. Lionel Corporation, 483 F.2d 540, 545 (2d Cir. 1973), cert. denied, 415 U.S. 918 (1974), Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 364 (2d Cir.), cert. denied, 414 U.S. 910 (1973).

POINT II

The District Court Erred in Finding That The Prospectus Was Not Materially Misleading With Respect To The Control Problem

Control was at the very heart of the Armour shareholders' choice between accepting Greyhound's $72 cash offer or Host's offer of its Debentures and Warrants. If Host gained operating control of Armour it became a company with $735.5 million in assets to manage; if it did not control Armour, it merely had $79 million in operating assets and an investment in Armour securities.

The importance of control, however, went beyond the assets that would be underlying the Host Debentures. Host had tried to project itself as having skilled management that could transform Armour from a rather stodgy old-line meat packer into a highly profitable and dynamic corporation. Thus, McDowell, an officer of Allen, Inc. working with Host on the Exchange Offer, characterized the Exchange Offer as follows. (JA. 287-288):

> ". . . (B)ut management of General Host comes along and says to Armour shareholders, okay, we will offer you a piece of paper whereby you will get on an annual basis interest which was more than you are getting as a dividend, considerably more in this case, and I will take over your company, and it is my belief that with the people that we have and the ideas that we have that we can make that company move forward better than the present management that has demonstrated that it hasn't been able to do this very well."

Even if Host acquired a majority of the Armour stock in its Exchange Offer, it found enormous obstacles in gaining operating control of Armour. As indicated in the Master Plan (sometimes referred to as the "Black Book" or "General Host Confidential Study of Armour") and in the Ashton Affidavit, Armour had a staggered Board and cumulative voting so Host could not take immediate control of Armour without the cooperation of the Armour Board and there was little prospect of that. Furthermore, Host knew that as long as the Armour management remained, Host's voting control was in jeopardy, as Armour had already sought to make two stock-for-stock acquisitions which would have substantially reduced Host's ownership interest in Armour.

Far from warning the Armour shareholders (i) that Host might not get operating control of Armour, or (ii) that Host might have to engage in a protracted court battle over whether the Armour Board had the exclusive right to modify the Armour by-laws, or (iii) that Host would have to buy additional Armour shares after the Exchange Offer in order to protect its majority stock position, the Prospectus gave no warning that Host might face serious obstacles to securing operating control of Armour even if it obtained more than 50% of the Armour common stock. On the contrary, it merely stated that:

> "General Host intends to act promptly both before and after the consummation of the Exchange Offer to obtain control of the board of directors of Armour and management of Armour. In this connection, it may engage in the solicitation of proxies for the election of directors

of Armour and other matters, both at the February 21, 1969 annual meeting of Armour and Company and otherwise."

This language suggests that if Host obtained more than 50% of the Armour shares, all that stood between Host and control of Armour were technical legal steps. The Armour shareholders could not possibly have understood from such language that Armour might be required to invest an additional $150 million in order to secure operating control of Armour.

In the very next paragraph, Host went on to state:

> "General Host may find it desirable upon consummation of the Exchange Offer to propose to stockholders of the relevant corporations a merger or consolidation of it or its present or future subsidiaries with Armour or certain of its subsidiaries, or General Host may find it desirable to dispose of portions of the assets presently held by it or by Armour. If no such merger or consolidation occurs and if General Host has not acquired more than 80% of Armour's Common Stock, which would allow it to enter into tax-saving arrangements, General Host may find it necessary or desirable to increase the dividend paid on common stock by Armour, or to incur new indebtedness or issue additional equity securities."

As Glynn testified, the presumption behind the suggestions that Host would (i) merge the two companies, (ii) dispose of certain Armour assets or (iii) increase the Armour dividends was that Host would be in control of Armour. (JA. 229-230).

Furthermore, Host also included pro forma financial statements (both income statements and balance sheets) showing a consolidation of Host and Armour, with Armour owning 51%, 60%, 80% and 100% of the Armour stock. Although both of these statements were preceded by narrative paragraphs which purported to explain their underlying assumptions and were followed by explanatory notes, nowhere was it stated that these statements would depict Host only if it were able to obtain operating control of Armour. Bettauer, Host's auditor, testified (JA. 153), and the AICPA's Accounting Research Bulletin No. 51 (Pl. Ex. 1) (JA.757-760) confirms, that it is wholly inappropriate to consolidate the financial statements of two companies (even if one owns more than 50% of the stock of the other), unless one has the power to control the operations of the other. Although the pro forma financial statements would have been appropriate had Host achieved operating control, to include them without stating that assumption was clearly misleading. In this regard, Glynn acknowledged that the SEC required that "the assumption upon which (pro forma) statements are prepared must be set forth clearly." (JA. 219).

The District Court failed to grasp the significance of the Control Problem, viewing it merely as being a part of the Cash Flow question and important only insofar as it related to Host's ability to pay the interest on theDebentures.

Thus, the Court observed:

> "[t]he evidence reveals, and plaintiff's own amended complaint confirms, that the primary issue at the time of the exchange offer was General Host's ability to meet its debt obligations under the debentures to be issued to Armour security holders pursuant to the exchange offer. The control issue-whether or when General Host could get operating control of Armour - was subsidiary to this cash flow issue and but a part of it." (emphasis supplied) (Opinion p.11, JA.711)

The control question had far greater significance. It was not merely a subordinate wrinkle to the Cash Flow Problem. It was at the very heart of whether there was any substance behind the paper Host was issuing in competition to Greyhound's cash offer of $72 a share and whether Host's management would operate Armour.

In Alaska Interstate Co. v. McMillian, CCH Fed. Sec. L. Rep. ¶ 95,276 (D.Del.1975), decided after Judge Weinfeld's decision here, Judge Stapleton was faced with facts closely paralleling the facts in this case. Contrary to Judge Weinfeld's decision, he held that failure to disclose impediments to control was materially misleading, and granted injunctive relief.

In the Alaska Interstate case, the tender offeror had failed to disclose restrictions imposed in voting trust and joint venture agreements and the existing dispute between the contestants as to the meaning of those provisions. The Court stated:

"The critical facts for present purposes are that at the time of Alaska's tender (1) the ability of the holder of a majority of the Apco Group's stock to secure working control of Energy turned on substantial and litigable questions, and (2) at least a majority of Energy's present board, in the Baldwin matter, had acted in a manner which indicated that they would not voluntarily accede to Alaska's control of Energy in the event it acquired Apco's Energy stock.

I agree with Energy's position that these were material facts. At the time of the Alaska offer, it appeared that substantial litigation stood between it and its stated goal of control of Energy and that there could be no assurance that that litigation would be successful.

* * *

It is fair to say that Alaska's tender materials convey the impression that, while not a certainty, acquisition of Apco's Energy shares should, through the vehicle of the voting trust, enable Alaska to obtain effective control of Energy. While it is also revealed that there were currently differences between Energy's Board and Mr. Honig and that Energy was itself tendering for Apco's stock and resulting control of Apco's Energy stock, nowhere is it disclosed in Alaska's tender that Energy's present board, whose directors the voting trustee was directed to follow by the Voting Trust Agreement, did not share Alaska's view that control of Apco's Energy shares "should, through the vehicle of the voting trust, provide...[Alaska] with effective control of Energy as well."

Energy is substantially larger than either Alaska or Apco both in terms of assets and earnings. In view of Alaska's stated goal of acquiring control of Energy, the potential for achieving this goal would be a significant consideration to an Apco stockholder in deciding how to react to the competing offers. Accordingly, the position of the Energy Board and the probability of litigation before control of Energy could be secured was something to which "a reasonable

man would attach importance in determining his choice of action in the transaction in question." Rochez Bros., Inc. v. Rhoades, 491 F.2d 402, 408 (3rd Cir.1974); Mayer v. Development Corporation of America, C.A. 74-73 (D. Del., March 21,1975). Alaska's tender was materially deficient in these respects. (Emphasis Supplied)

The similarities between the two cases are striking. Both arose out of hotly contested exchange offers; both centered on whether a majority stockholder could exercise control over the target company's assets; and both involved an attempt by a smaller company to take over a larger company. In both cases, the would-be majority shareholder was opposed by the target company's management; in both, the road to control was blocked by legal impediments (by-law provisions in this case - contractual provisions in Alaska Interstate); in both there was a dispute between the parties as to the interpretation of those provisions; and in both, the party seeking control failed to mention the obvious impediments standing in its way.

Plaintiff submits that Judge Stapleton's reasoning in the Alaska Interstate case is sound and speaks to the realities of the situation in both cases. Nothing could be more important in a contest for control than control itself. In concluding that the Prospectus was not materially misleading in failing to spell out the risks that control would not be forthcoming, Judge Weinfeld erred. It is a measure of how wide he was of the mark that he concluded, with respect to the Ashton Affidavit, quoted at pp. 13 and 14, supra and sworn to less than a week before issuance of the Prospectus,

that "its tone and emphasis is consistent with the Prospectus language, and this is unquestionably so when viewed in its proper context." (Opinion, p. 35, JA. 735) If this affidavit and the pertinent language on page 9 of the Prospectus are placed side by side, the conclusion is inescapable that they are at opposite poles, and that Armour's security holders were entitled to the same explicit disclosure and candor which it suited Host's purpose to exhibit in defense of the Antitrust Action. Judge Weinfeld's conclusion is inexplicable in view of the fact that he had found that

> "it was manifest that even if General Host acquired a majority of the [Armour] stock, the battle for operating control would continue for a period." (Opinion p.32; JA.732)

POINT III

The District Court Erred In Finding That The Prospectus Was Not Materially Misleading With Respect To The Cash Flow Problem.

The Cash Flow Problem was also obviously material. The Armour shareholders were faced with the choice of retaining their Armour stock, taking $72 in cash from Greyhound or taking an interest bearing security from Host. Whether or not Host would be able to pay the interest on the Debentures and Host's senior indebtedness was therefore of the utmost importance.

Under the Exchange Offer, if Host received 51% of the Armour common stock it would be required to pay annual interest costs on the Debentures of almost $10 million at a time when its historical pretax earnings were only slightly more than $3 million per year. To convince the Armour shareholders that this was not a problem and that Host would have no trouble paying the interest on its Debentures, Host created the illusion that if the Exchange Offer yielded more than 50% of the Armour stock, Host would take control of Armour and have the Armour assets at its disposal. (As discussed in Point II above, the Prospectus was materially misleading in this respect). But Host also set out to convince the Armour shareholders that it had sufficient cash (or, at least, access to cash) to service its debts until such time as Host actually obtained control of the Armour assets. To that end, it had omitted from the preliminary Prospectus any reference to the Cash Flow Problem. In the Prospectus itself, rather than describing the risks attending the cash flow question, Host inserted the following paragraph on page 9 under the caption, "Other Aspects of the Exchange Offer".

> "General Host may find it desirable upon consummation of the Exchange Offer to propose to stockholders of the relevant corporations a merger or consolidation of it or its present or future subsidiaries with Armour or certain of its subsidiaries, or General Host may find it desirable to dispose of portions of the assets presently held by it or by Armour. If no such merger or consolidation occurs, and if General Host has not acquired more than 80% of Armour's Common Stock, which would allow it to enter into tax-saving arrangements, General Host may find it necessary or desirable to increase the dividend paid on common stock by Armour, or to incur new indebtedness or issue additional equity securities."

This language was misleading in two principal respects. First, it gave the false impression that Host would be able to utilize the Armour assets and earnings to satisfy Host's cash requirements - by merging the two Companies, by increasing the Armour dividends, or by entering into a tax saving arrangement. All of these required that Host have control of the Armour Board - an assumption which was both questionable and unstated. Furthermore, to effect a merger, Host would have also required the approval of the holders of 2/3 of the Armour shares, a significant obstacle in view of Greyhound's competing tender offer. There was no warning that majority ownership by Host would not be sufficient to effect a merger even if Host controlled the Armour Board.

Secondly, the language in no way warned the Armour shareholders that there was a foreseeable need for Host to take any of these possible alternatives. It merely suggested that Host "may find it desirable" to do these things. It is inconceivable that any reasonable investor could have concluded from this paragraph that Host would be faced with a serious Cash Flow Problem resulting from the differential between Host's obligations on the Debentures and any dividends which it might receive from Armour.

Day testified that immediately following the Armour shareholders' meeting on February 21, 1969, he was instructed to prepare a cash requirement analysis which showed that, assuming it would take three years for Host to gain control of the Armour assets, Host would need an additional $40 to $50

million. (JA. 128). For a company with a net worth of approximately $37 million, this is a staggering prospect and should have been dealt with in the Prospectus. Could any Armour shareholder have reasonably anticipated this type of cash requirement on the basis of the language quoted above?

The securities laws have long since rejected the horoscope style of writing prospectuses. An issuer cannot satisfy its disclosure obligations through bland generalities fraught with ambiguities. [22]

This principle was clearly stated in Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66 in 1969, affirmed, 478 F. 2d 1281 (2d Cir. 1973) where the lower court stated:

> **"Under the anti-fraud provisions of the Federal Securities Acts, stockholders must be fully and completely informed. Under these provisions there is no room for technical explanations and tight-lipped announcements and all doubt arising from ambiguous statements must be resolved in favor of the stockholders." (at p. 95)**

Although not stated in the Prospectus, Host was relying on internal projections of income to service the Debentures. The district court found that it would have been inappropriate to include these projections as the SEC

[22] The district court concluded that the disclosure in the Prospectus was adequate on the cash flow question, giving "some weight" to the fact that the Prospectus had been cleared by the SEC which had been advised of the problem by Armour. (Opinion p.19; JA.719) Such a conclusion was error and this is evidenced by the SEC's subsequent action (73 Civ.275 SDNY) against Host based, among other things, upon the misleading character of the cash flow disclosures in the Prospectus

was then taking the position that the inclusion of projections was *per se* misleading. Plaintiff, however, was not suggesting that the projections should have been included as the plaintiff agrees that these projections were, in fact, misleading. Rather, plaintiff contended below that the fact that Host was relying on projected earnings should have been disclosed. In essence, plaintiff contends if it is misleading to use projections, it is even more misleading to use projections and not so indicate. This was especially important since the defendant's expert witness testified that most economists were then looking for a reduction in the economy's growth (JA. 512), which would have necessitated an adjustment in the Host projections which had been prepared "sometime before". (JA.476)

If the Armour shareholders had been informed that Host in all likelihood would have had to take extraordinary measures to pay the interest on their Debentures rather than service them out of internally generated earnings, they may well have decided not to accept the Host Exchange Offer.

POINT IV

The District Court Erred in Holding That Any Material Omissions or Misstatements In The Prospectus Were Cured By A Reference Buried in An Annex To The Prospectus Or Materials Published Or Disseminated Outside The Prospectus

The District Court concluded that the Armour security holders were not misled, stating:

> "Far from being misled, Armour shareholders were thus inundated with information concerning their own corporation's staggered board and its cumulative voting provisions. The bombardment of the Armour shareholders by communications and publications hardly suggests that they were misled into believing that General Host would achieve immediate control of Armour's Board of Directors if it obtained more than 50% of the Armour shares. To the contrary, it was manifest that even if General Host acquired a majority of the stock, the battle for operating control would continue for a period." (Opinion p.32; JA.732)

The court's conclusions were in error for four reasons: (1) the Prospectus told nothing of the battle that lay ahead, much less intimate its possible magnitude, (2) "piecemeal disclosures" and "buried facts" cannot cure a misleading prospectus; (3) the representations made by the Armour management tended to buttress the misapprehension that if Host acquired more than 50% of the Armour stock it would achieve operating control; and (4) mere disclosure of the staggered board and cumulative voting provisions in an annex without a cross reference or an explanation of their significance, was not sufficient to apprise the Armour stockholders of the Control Problem.

(a) Reference to the Staggered Board and Cumulative Voting in an Annex to the Prospectus was Inadequate Disclosure of the Control Problem.

The conclusion that a routine reference to Armour's cumulative voting and staggered board provisions on page A-9 of Annex A to the Prospectus satisfied defendant's obligation to make full disclosure regarding the risks involved in Host's ability to be assured of immediate control of the Armour board cannot be reconciled with the undisputed significance of failure to achieve such control. (JA. 162) The facts should have been highlighted in the body of the Prospectus in the context of the statements made at p.9 which represented that Host would have the ability to control Armour's assets, and should have been described in the same detail as they were in the Ashton Affidavit. Their "piecemeal presentation" in the annex (which in itself was inadequate) "..was inadequate disclosure under the securities laws." Kohn v. American Metal Climax, Inc., 458 F.2d 255, 265 (3rd Cir.), cert. denied, 409 U.S. 874 (1972); Gould v. American-Hawaiian S.S.Co., 331 F.Supp. 981, 996 (D.Del.1971); Norte & Co. v. Huffines, 304 F.Supp. 1096, 1106 (S.D.N.Y.1968), modified on other grounds, 416 F.2d 1189 (2d Cir. 1969), cert. denied, 397 U.S. 989 (1970).

In *Mills* v. *Electric Auto-Lite Co.*, 403 F.2d 429 (1968), *vacated on other grounds*, 396 U.S. 375 (1970), the Seventh Circuit held that a misleading statement made in the forepart of a proxy statement in bold letters could not be cured by a second, less prominent statement in the latter part of the proxy statement. In *Mills*, shareholders of two affiliated companies were being asked to approve a merger. In the forepart of the proxy statement in BOLD type was a statement to the effect that the Boards of both companies had approved the merger. Although this was true, it was misleading without knowledge that the Boards of the two companies shared four of eleven directors which was disclosed in a less conspicuous manner. The court ruled that this imbalance of disclosure rendered the proxy materials misleading, stating:

> "We conclude, in agreement with the district court, that as a matter of law the proxy statement failed, in connection with the advice tendered by the board, adequately to bring out the relationship between the board members and Mergenthaler. This, in terms of the rule, was an omission of a material fact necessary in order to make the statements therein not misleading." 403 F.2d at 435.

Here, even had an extraordinarily diligent investor unearthed the brief reference to the cumulative voting provisions, he would not have known its significance as the Prospectus nowhere disclosed that a staggered board and cumulative voting might prevent Host from ever gaining control of the Armour board and would prevent Host from using the Armour assets

and earnings to satisfy its own cash needs as represented in the section entitled "Other Aspects of the Exchange Offer" on p. 9 of the Prospectus.

As the District Court observed in the Kohn case, supra,

> "The Securities Exchange Act requires more than disclosure, it requires adequate disclosure. The more material the facts, the more they should be brought to the attention of the public. To view it otherwise would be to invite frustration of the policies underlying our disclosure laws. Accordingly, we have found certain facts to be 'buried' in the explanatory materials. These facts should have in some way been highlighted to insure that the shareholders were aware of them." Kohn v. American Metal Climax, Inc., 322 F.Supp. 1331, 1362 (E.D.Pa.1970), aff'd as to this point, 458 F.2d 255 (3d Cir.1972).

Thus, in this case, the impediments to Host's gaining control over Armour and the consequences of failure to gain control should have been emphasized, rather than omitted or buried.

The way in which proper disclosure should have been made was well articulated by Mr. Gould at the trial as follows:

> "Could it have been done better? Yes, your Honor. I am sure that there could have been something written on the front page of this cover, as we write certain things on the front page of every cover in black type saying: By the way, we are not sure of getting control. By the way, if we don't control, this is what is going to happen." (JA. 354-355).

That is precisely the disclosure and emphasis which could and should have been given in the Prospectus.

(b) Materials Published or Disseminated Outside the Prospectus Did Not Cure Its Material Defects

In Sonesta International Hotels Corp. v. Wellington Associates, 483 F.2d 247, 255 (2d Cir.1973), this court stated:

> "While the failure of a target company to seize an opportunity to rectify claimed omissions may have some bearing on their materiality, General Time Corp. v. Talley Industries, Inc., 403 F.2d 159, 162 (2d Cir. 1968), cert. denied, 393 U.S. 1026 (1969), and while it would have been in the interests of disclosure for Sonesta itself to have drawn its stockholders' attention to the possible consequences of their tendering Sonesta shares, which Wellington had omitted, it would emasculate the purposes of the Williams Act to allow the offeror to look to the target company to remedy the offeror's own material deficiencies in disclosure. The obligation is placed squarely on those making the offer in the first instance to disclose all material factors necessary to make their offer not misleading. That duty cannot be shifted to the shoulders of others. (emphasis added)

Moreover, in Titan Group, Inc. v. Faggen, 513 F.2d 234, 239 (2d Cir.1975), this court reiterated:

> "In cases involving non-disclosure of material facts, even when coupled with access to the information, materiality rather than reliance thus becomes the decisive element of causation. See, e.g., Metro-Goldwyn-Mayer, Inc. v. Ross, 509 F.2d 930 (2d Cir.1975); Steir v. Smith, 473 F.2d 1205 (5th Cir.1973). And determination of materiality allows logically an inference of reliance. Chris-Craft Industries Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973). See, generally, Note 88 Harvard L. Rev. 584 (1975)." (emphasis added)

Those decisions are consistent with the holding of the Third Circuit in Kohn v. American Metal Climax, Inc., supra, 458 F.2d at 265, as follows:

> "Defendants contend that although their own presentation may indeed have been piecemeal, the shareholders were fully apprised of the benefits accruing to AMAX by means of the letter of plaintiff Kohn which was included in the proxy materials sent pursuant to court order and which urged the shareholders to vote against the proposal. It is true that proxies need not contain information contained in other solicitation material as long as the proxies clearly refer to such other material. See Rule 14a-5, 17 C.F.R. §240.14a-5(c). But a reading of Rule 14a-5 in its entirety reveals that its sole purpose is to control the manner of presentation of data within proxies. It is aimed at reducing repetition within materials sent to stockholders. It does not authorize opposing sides in proxy contests to use one another's materials by reference. Consequently, any otherwise material violation of the disclosure rules is not obviated by referring to materials of an opposing soliciting party. The result is the same even if the issue is considered apart from Rule 14a-5." (emphasis added)

Accord: Ronson Corporation v. Liquifin Aktiengesellschaft, 370 F.Supp. 597, 602 (D.N.J.1974), aff'd on other grounds, 497 F.2d 394 (3d Cir.1974).

In concluding, nevertheless, that adequate disclosure was made on consideration of the "total mix" of the information conveyed to the Armour security holders, the district court lost sight of the realities of the situation and mis-applied the principle of those cases (derived in completely different contexts) that materials outside the Prospectus can be taken into account. The fundamental principle is to determine whether there is balanced disclosure. Disclosure cannot be balanced unless it is effective.

That was enunciated in Smallwood v. Pearl Brewing Company, 489 F.2d 579 (5th Cir.), cert. denied, 95 Sup. Ct. 134 (1974), relied on by the district court, as follows:

> [It is] "important to put to rest one of the appellees' arguments on which we do not rely; that is, that the disclosure in the proxy materials of the power of the Pearl Board to waive the underwriting commitment immunized a lack of similar disclosure in the November 18 letter. We cannot accept the premises that prior disclosure in one communication will automatically excuse omissions in another. As we indicated above, the adequacy of disclosure is a function of position, emphasis, and the reasonable anticipation that certain future events will occur. Perception of future events may take on a different cast as the future approaches, and, what is more important, later correspondence may act to bury facts previously disclosed. A balance once struck will not ensure a balance in the future. As new communications add a dash of recommendation, a pinch of promise, and a dusting of repetition, the scale may be tipped. To prevent an injustice to the shareholders, the elements must be weighed each time that the shareholders are requested (or encouraged) to make a new decision. See Chris-Craft Industries, Inc. v. Piper Aircraft Corp., supra 480 F.2d at 365 n. 18." 489 F.2d at 606. (emphasis added)

The reference in Smallwood to Chris-Craft relates to the holding by this Court that disclosure of certain facts in "a detailed and extremely complex prospectus,..." did not excuse failure to make the disclosure in letters sent to the stockholders. Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 365 n.18 (2d Cir.1973), cert. denied, 414 U.S. 910 (1973). The part of the Chris-Craft opinion on which defendants relied in the district court

emphasized that in the letters in which disclosure was made:

> "The nature of the Piper family's personal stake in the exchange offer was fully described. We therefore conclude that this omission was rendered harmless." 480 F. 2d at 377 23/

As will be discussed more fully below, the alleged curative statements in this case were insufficient in substance to effectively offset Host's omissions as they did in Chris-Craft. Furthermore, the statements of the Armour management were contained in documents, the major thrusts of which were to affirm the misleading aspects of the Host Prospectus. The alleged curative statements were also made in the context of other matters and completely unrelated to the misleading statements which they were alleged to cure. Lastly, they were made out of time sequence - either in advance of the Prospectus or late in the Exchange Offer period. 24/

23/ The court in Chris-Craft held it to be a material omission that the stockholders were not informed of a "put," whereby Grumman was permitted to return the entire 300,000 shares which it had acquired, in return for its purchase price, although the "put" had been described in Piper's application for listing with the New York Stock Exchange. 480 F.2d at 365.

24/ It is important to note that there was an element of estoppel present in Chris-Craft that is not applicable to the Armour shareholders. In Chris-Craft, the plaintiff was not a shareholder caught in the middle of the struggle for control, but rather, one of the contestants in that struggle. Indeed, it would have been difficult for Chris-Craft, the author of the curative statements, to contend that its attempts to cure the misleading statements made by the Piper management were inadequate. No such estoppel principle applies in this case.

In Smallwood v. Pearl Brewing Company, supra, the plaintiff contended that the failure of merger proxy materials to note that the corporation being acquired could waive a condition to a merger - that the acquiring corporation obtain an underwriting commitment with respect to the shares it was issuing - was misleading and in violation of rule 14a-9. The defendant contended that the reproduction of the entire merger agreement (including the waiver provisions) in an appendix to the proxy statement was adequate notice under the circumstances. On appeal the Fifth Circuit took notice of the balanced disclosure doctrine, but reasoned that failure to highlight the waiver provisions was justifiable, since at the time the proxy statement was published it was not reasonably foreseeable that the surviving corporation would not be able to obtain the required underwriting commitment. In this regard, the court stated:

> "It is enough that proxy statements be complete and not misleading in light of the circumstances existent and reasonably anticipated at the time distributed. See Rule 14a-15, 17 C.F.R. §240.14a-5; Miller v. Steinbach, S.D.N.Y. 1967, 268 F.Supp. 255, 276.
>
> Smallwood failed to produce any evidence at trial that as of August 12, 1969, the defendants anticipated, or should have anticipated, that Southdown would be unable to obtain an underwriting commitment pursuant to the merger agreement. The uncontradicted testimony was that Pearl's attorney, Guenther, sought and received confirmation from Lehman Brothers before the merger agreement was signed that such a firm commitment was possible. Moreover, Lehman Brothers was prepared, at least into November 1969, to go through with the underwriting. We find that there was ample evidence for the jury to find that considering the totality of circumstances the waiver power was adequately

disclosed.

* * *

"We base our holding on the lack of evidence that anyone should reasonably have anticipated that the waiver provision would be material to the shareholder's decision to approve or disapprove the merger. (Emphasis Supplied) 25/

The Fifth Circuit emphasized that the plaintiff had submitted no evidence to indicate that at the time the proxy statement was distributed it was reasonably foreseeable that the requirement for an underwriting commitment could not be met. The trial court here viewed the issue in terms of whether the defendants might have reasonably thought that Host would obtain control of Armour if it secured more than 51% of the Armour stock. The decision in Smallwood, however, requires a finding of the converse - namely, that it was not reasonably foreseeable that Host might be unable to obtain control of Armour, either immediately or eventually. No such finding could be made on the record here. Ashton, Host's President, only a few days prior to the effective date of the Prospectus, had submitted an affidavit in the Antitrust Action to the effect that the acquisition of a majority of the Armour shares would not give Host control of Armour because of the staggered board and cumulative voting provisions. (See pp.13-14 supra.)

25/ Although the Fifth Circuit was apparently reluctant to reverse the finding of the jury, it nevertheless did undertake a review of the disclosure made by the defendant.

Bettauer testified that he had discussed with high corporate officers of Host immediately prior to the effective date that Host would have "a difficult time" if it obtained less than 80% of the Armour shares. (JA. 148). Furthermore, Host was fully aware of Greyhound's presence and the determination of the Armour Board to fight a Host takeover. Thus, unlike Smallwood, there was uncontroverted evidence that the undisclosed contingency was not only foreseeable but, in fact, foreseen.

Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 873 (2d Cir.), cert. denied, 95 Sup. Ct. 150 (1974), cited by the district court, is also inapposite. There the issue was whether the possibility of an antitrust violation should have been disclosed. The district court found that:

> "...it would not have been unreasonable for Cargill's management to have concluded after appropriate inquiry that no substantial antitrust obstacles stood in the way of its acquisition. Therefore, under the circumstances before us, the possibility that the acquisition would result in antitrust violations, a possibility that exists with every merger, need not have been disclosed to Missouri Portland's shareholders." 498 F.2d at 872, n.44 (emphasis supplied)

This Court agreed with that analysis, but went further, concluding that:

> "...under the circumstances it would have been reasonable for Cargill's management to conclude that no antitrust obstacles actually existed." 498 F.2d at 872.

It was immediately following that conclusion that the Court

stated:

> "Courts should tread lightly in imposing a duty of self-flagellation on offerors with respect to matters that are known as well, or almost as well, to the target company; some issues concerning a contested tender offer can safely be left for the latter's riposte." 498 F.2d at 873

The distinction from this case is apparent. Host and its executives knew that "substantial...obstacles stood in the way of..." their achieving timely control of Armour. The Prospectus gave a contrary impression, omitting to state the necessary, material facts. The narrow exception to the balanced disclosure doctrine carved out in the Smallwood and Missouri Portland cases requires a finding that the undisclosed event could not be foreseen, not that it was foreseeable that it might not occur.

Moreover, Armour's "riposte" did not adequately disclose what the Host Prospectus had materially misrepresented and omitted. One such communication was the Armour letter to its shareholders dated January 9, 1969 and reprinted in the Wall Street Journal on that date (approximately three weeks before the Exchange Offer) (Def. Ex A-25 and A-26) (JA. 1084 and 1085). It began by stating:

> "General Host...has filed a Registration Statement covering an Exchange Offer it proposes to make to Armour stockholders in an effort to obtain control of Armour."

The letter went on to discuss the "Packers" consent decree of 1920 and how a takeover by Host would violate that decree,

concluding:

> "In the opinion of Sullivan & Cromwell and Kirkland, Ellis, Hodson, Chaffetz & Masters, Counsel to Armour, control by General Host, as now constituted would be a flagrant violation of the principles of the Packers' Consent Decree of 1920." (emphasis supplied)

At the end of the letter is a discussion of the cash flow question in which the following reference to the Armour staggered board appears:

> "so long as there continue to be any public stockholders of Armour, even if General Host were in control of Armour's Board of Directors, which is classified and elected for three-year terms, General Host could not use Armour's assets and cash flow -- except by the declaration of dividends -- to service General Host's indebtedness." (emphasis supplied)

This letter was clearly designed to warn the Armour shareholders not to accept the then proposed Host Exchange Offer because of the potential antitrust and cash flow problems. These statements equated Host's ownership of a majority of Armour stock with control of Armour, although suggesting that as a fiduciary Host would be unable to use the Armour assets for its own purposes. The single elliptical reference to Armour's staggered board, tucked away in a discussion of the Cash Flow Problem at the end of the letter, could not dispel the dominant and false impression created in the first part of the letter that "control" of Armour would pass to Host.

On January 17, 1969 (approximately two weeks before the Exchange Offer), Armour sent to its shareholders proxy materials for the election of directors for the annual meeting to be held on February 21, 1969 (JA.1089) (Def. Ex A-29). Although the proxy statement mentions (i) that Armour's board of directors is classified, (ii) that 6 of the 17 directors are to be elected at the annual meeting and (iii) that cumulative voting applies, it makes no mention of the impending Exchange Offer or in any way indicates that there is a relationship between the election of directors at the annual meeting and Host's ability to take control of Armour in the event it acquires a majority of the Armour stock. Indeed, because of the separation in time and the want of an expressed relationship between the two documents, an Armour shareholder reading the Prospectus would have likely concluded that the election of directors as contemplated in the Armour management's proxy statement would be superseded in the event Host acquired a majority of the Armour shares.

On February 10, 1969 (11 days after Host made its Exchange Offer), the Armour management sent a final letter (JA. 1435-1442) to its shareholders (which was also reprinted in the Wall Street Journal - (JA. 1443) Def.Ex. A-65) together with supplemental proxy material (JA. 1435-1442) (Def.Ex. A-64). The letter made no mention of either the cumulative voting or the staggered Board provisions.

Instead, it concentrated on the Cash Flow Problem and, if anything, tended to reinforce the false impression conveyed by the Prospectus that Host would obtain control of Armour if it acquired a majority of the Armour shares. Thus, it concluded:

> "There is no assurance, however, that Greyhound will retain the Armour shares acquired by it, if General Host acquires more than 50% of the Armour shares."

Although this letter was intended to cause the uncommitted Armour shareholders to tender to Greyhound because of the uncertainties posed by Host's Cash Flow Problem, it may well have had a reverse affect. 26/ The letter was mailed on February 10, 1969 and stated that "The Greyhound offer expires February 10, 1969, unless extended." It also implied that if Host was successful, it would cause the two companies to merge and Host would dig deep into the Armour assets to service its debts. Thus, the Armour shareholder receiving this letter (and who had not already tendered) might have noted that it was too late to tender to Greyhound, and faced with the decision of either holding Host Debentures and Warrants or Armour common stock might have decided in favor of the Debentures and Warrants. After all, if Host was successful and things were as bad as Armour had described, the Armour shareholder was better off holding debt

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26/ Under the terms of the Exchange Offer all tenders of Armour shares were irrevocable. Thus, an Armour shareholder who had previously tendered his shares and who, by reason of the Armour disclosures became aware of the problems confronting Host, could not have revoked his tender.

and equity securities of the combined companies. On the other hand, if Host did not get a majority of the Armour common stock, he would get his Armour common stock back.

The only references to the staggered board and cumulative voting provisions were contained in the accompanying supplemental proxy material, which was not reproduced in the media. The supplemental proxy material was primarily designed to satisfy the requirements of Schedule 14B for contested elections and was filled with detailed information concerning management's nominees for the Armour Board and all purchases and sales of Armour stock by its Board members during the preceding two years. It is important to note that Armour sent two separate documents - the letter which related to the Exchange Offer and the supplemental proxy statement which related to the election of directors at the annual meeting - with no indication in either document that one had any bearing on the other.

As noted above, the January 9, 1969 letter in two fact-filled paragraphs also discussed Host's potential problem in servicing its debts. This discussion, however, was in terms of Host's per share earnings (with references to the dilutions that would be caused by the exercise of the Warrants) and not in terms of Host's cash flow, and concluded with the

following statement:

> "But these figures do not mean that General Host would have the cash flow necessary to service its greatly increased debts."

The average investor having read this statement might have deduced that the Armour management was conceding that Host would probably have sufficient funds to pay the interest on the Debentures, but was merely mentioning these figures as a speculative possibility. Indeed this language is followed by:

> "In contrast to these dubious and speculative values, Armour's prospects were never brighter."

It was only when the Armour shareholders received the second letter from the Armour management, dated February 10, 1969, (the eleventh day of the Exchange Offer) that they were told that "General Host's pro forma operations simply will not generate enough cash to meet its interest requirements unless it can ultimately merge with Armour." At that point, it may have been too late, since the Armour shareholders were not given the opportunity to revoke their tenders made prior to the expiration of the tender offer.

In any event, the second letter did little more than raise the Cash Flow Problem. The arguments of the Armour management in that letter were based upon Host's "reported" earnings for the fifty-two week period ended October 5, 1968 and certain assumptions made by Armour. The Armour management

made no claim of actual knowledge of Host's financial status and made no attempt to analyze Host's cash position, its untapped credit lines or to take into consideration the changes in Host's capital structure after October 5, 1968. Thus, the second Armour letter did not provide sufficient information on which the Armour shareholders might have reached a reasoned decision as to the magnitude of Host's cash flow problem.

It is unlikely, however, that the Armour shareholders would have given any weight to these communications. On January 23, 1969 - approximately two weeks after the first Armour letter and one week before the effective date of the Prospectus - Armour had brought its action against Host seeking to enjoin the Exchange Offer on the basis of alleged misleading statements in the preliminary prospectus. On January 27, 1969, Armour's application for a temporary restraining order was denied and a few days later Armour's motion for a preliminary injunction was likewise denied. The Prospectus, on page 8, pointed out that the court had denied Armour's petition for a restraining order. Armour's second letter disclosed the denial of its motion for a preliminary injunction.

The Prospectus also contained a discussion of the ex parte efforts of the Armour management to have the Exchange Offer blocked by the Illinois Security Commission and Armour's unsuccessful effort to have the Justice Department block the Exchange Offer on anti-trust grounds. Thus, the Prospectus

belittled the objections being raised by the Armour management as the desperate efforts of a management out to protect its jobs at all costs. In fact, Glynn testified that Host's impression was that the Armour management "was prepared to do anything regardless of whether or not it was detrimental to the interest of the Armour shareholders" to defeat Host. (JA. 232-3).

Furthermore, Host's disclosures were made in a document which had been cleared by the Securities and Exchange Commision, a fact which the trial court thought deserved "some weight". The Armour management, on the other hand, was making its claims in letters and paid advertisements which were not subject to regulatory review. Therefore, even assuming that the Armour letters had made all of the necessary disclosures, they would have been insufficient to overcome the misleading impression conveyed by the Prospectus.

As the district court found, the Armour shareholders were "inundated" and "bombarded" on all sides. Clearly, they were entitled to look to the Prospectus itself as the lodestar to guide them through the maze; and, in all probability, they viewed it as such. Viewing the "total mix" in the circumstances of this case, it cannot be fairly concluded that the misstatements and omissions in the Prospectus itself were cured by outside communications. In so concluding, on the undisputed facts, the district court was in error.

POINT V

Plaintiff Has Established The Element of Scienter

Since the district court based its decision on the conclusion that there were no material misstatements or omissions, or, if there were, they were cured by the "total mix", it had no occasion to address the question of "scienter". There can be no doubt that the defendants were acutely aware of both the Control and Cash Flow Problems. In fact, within a week before the effective date of the Prospectus, Host had been forced to consider both of these issues. The government in the antitrust action had asserted that Host's proposed acquisition of Armour shares would violate the Packer Decree. In response to this move, Ashton, the President of Host, submitted an affidavit strongly maintaining that ownership of a majority of the Armour common stock would not give Host control of Armour. Similarly, the constant attacks by the Armour management had forced Host to prepare cash flow projections which it submitted to the SEC staff.

The record clearly establishes scienter on the part of Host and its principal executives, Ashton and Pistell, beyond doubt. Ashton testified that he and Pistell were responsible for preparing the Prospectus (JA. 398); he personally reviewed the Prospectus (JA. 413); he always realized that having a control

block was not the same as having control of the company; and he knew that it might take as much as two years - through three annual meetings - to achieve control. (JA. 414-415). His affidavit in the Antitrust Action - sworn to only a few days before the Prospectus became effective - spelled out in detail the problems that Host faced in obtaining control of Armour. The very fact that he found it significant to submit this affidavit in the Antitrust Action is evidence of his awareness of the control problem.

Pistell, like Ashton, in October 1968 reviewed the Master Plan in which the legal questions posed by Host's takeover strategy were anticipated. The failure of Pistell and the other defendant directors of Host to testify in their own behalf gives rise to an inference that their testimony would have been adverse to them. See Stonehill v. Security National Bank, CCH Fed. Sec. L. Rep. ¶95,224 (S.D.N.Y. 1975) at p. 98,177. These defendants "either knew the material facts that were misstated or omitted and should have realized their significance, or failed or refused to ascertain and disclose such facts when they were readily available to [them] and [they] had reasonable grounds to believe that they existed." Cohen v. Franchard Corp., 478 F. 2d 115, 123 (2d Cir. 1973). See also Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F. 2d 341 (2d Cir. 1973, cert. denied 414 U.S. 910 (1973). That test is satisfied not only as to Host, Ashton and Pistell, but also as to all of the Host directors.

Defendants Allen Co. and Allen Inc. likewise were fully aware of the deficiencies of the Prospectus.[27] Herbert A. Allen, one of the two general partners of Allen Co. and the President of Allen Inc., testified that he had read and understood the Prospectus thoroughly (JA. 263); that Allen Inc.'s job was to perform a full review of the Prospectus; and it was their obligation to perform such a review (JA. 274). Having assumed that responsibility, it was reckless of Allen to cavalierly disregard the question of control, particularly when he was fully aware of the antagonism for Host harbored by the Armour Board (JA. 262). In fact, when he was questioned regarding the control problem, he testified that he was not employed by Host to render legal advice (JA.269).

His reckless attitude can be guaged from the following testimony:

> "Q. Did you consider General Host's ability to get more than a majority control of the Armour board of directors an important fact in advising General Host on how to proceed?
>
> A. When?
>
> Q. Let us say between the time you were first retained as dealer-manager and the expiration of the exchange offer.

27/ Judge Weinfeld also stated that he assumed "that a company that is preparing a tender offer obviously is discussing (with its investment banker) almost every fact that is pertinent to the situation, the market as well as the lender of the company." (JA.257).

A. I didn't direct myself to the subject during the period of the tender offer.

Q. How about prior thereto?

A. Following the tender offer --

Q. I said prior.

A. Prior to the tender offer I was aware that Armour had a staggered board -- and that Host would have to deal with this problem accordingly.

Q. When you say it would have to deal with this problem accordingly, did you have anything in mind as to how it would proceed with the problem aside from discussions with management in trying to use persuasion?

A. I don't remember having anything specific outside of what I spoke about during the period of this testimony this morning, the three or four things that I discussed with you.

Q. Did you seek any legal advice at that time concerning what steps might be taken through court action to achieve that result?

A. I believe I discussed it with Harris Ahston. I don't believe that I personally sought any legal advice with respect to the subject.

Q. What did you say to Harris Ashton and what did he say to you?

A. Roughly characterizing, I think I said that I assume that you will do whatever you can in order to deal with the problem.

Q. What did he say?

A. I don't remember his answer. I don't remember his disagreeing with that assumption.

Q. Did he say that he had something in mind as to how to deal with it?

A. I don't remember.

Q. Did you ask him what he had in mind?

A. I don't -- I don't recall if I did. I really thought that my theory, which was a business theory, which I had seen applied successfully recently, would have sufficed, but I didn't really consider the staggered board a significant problem." (JA 264-266) 28/

Defendants claim that they had no reason to suspect Host would have any difficulty in obtaining control of Armour if Host acquired a majority of the Armour shares.[29/] In support of this claim, they pointed to the opinion expressed by Herbert A. Allen that based upon his experience in the National General-Great America contest for control (JA. 268), the Armour Board was bound to surrender in the face of Host's obtaining more than 50% of the Armour shares. The defendants also pointed to an opinion of an associate of Connolly, Bove & Lodge, dated February 7, 1969 (8 days after the effective date of the Prospectus), to the effect that the Armour management could not prevent Host, as a 51% stockholder, from calling a special meeting of the Armour shareholders for the purpose of amending

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28/ As Dealer-Manager under the Prospectus, particularly having assumed the obligation of a thorough review of the Prospectus, Allen Inc. is fully liable for its material defects. Chris-Craft Industries, Inc. v. Piper Aircraft Corp., supra, 480 F. 2d at 370. Allen's testimony establishes that his company did not "reach a careful, independent judgment based on facts known to it as to the accuracy. . ." of the Prospectus. Id. at 371. The opposite is true. There was a complete abdication of the underwriter's duty. See Sanders v. John Nuveen & Co., Inc., CCH Fed. Sec. L. Rep. ¶95,347 (7th Cir. 1975).

29/ In contrast to this contention, McDowell, a Vice President of Allen Inc. assigned to the Exchange Offer, stated in a deposition taken on February 19, 1969 (only 5 days after the Exchange Offer) that Host having obtained 51% of the Armour stock had "a reasonable chance" to obtain control of Armour. (JA. 290).

the by-laws to delete the staggered board and cumulative voting provisions. This opinion, however, stated that the Delaware statute was silent on the question and that there were no decisions on it. (Def. Ex. A-61; JA.1432)

The defendants could not have derived any comfort from these opinions, much less assurance that the road to control would be so clear as to justify their failure to mention in the Prospectus the pending obstacles - obstacles which they deemed so substantial in defending against the government's motion in the Antitrust Action. The very fact that Host thought it important even after the effective date to obtain the opinion of its Delaware counsel - an opinion which was far from conclusive - is evidence of Host's deep awareness of the seriousness of the problems which it was seeking to suppress.

POINT VI

The District Court Erred In Dismissing The Action Against Allen Co.

At the conclusion of the trial, the trial court dismissed the complaint insofar as it pertained to Allen Co. (JA. 525). This ruling was erroneous. The evidence established that Allen Inc. and Allen Co. were so closely interrelated as to make Allen Co. liable for the actions of Allen Inc. for two reasons: (1) Allen Co.'s establishment of Allen Inc. was in itself a fraudulent and deceptive scheme in violation of Section 10(b) designed to mislead the investing public to believe that Allen Inc. and Allen Co. were one and the same company; and (2) Allen Co. was a controlling person of Allen Inc. and under Section 20(a) is liable for the latter's violations of the provisions of the Securities Exchange Act

Allen Co. was at the time of the Exchange Offer a limited partnership, having been engaged in various aspects of the securities business since its formation in 1922 (JA. 649) (Stip. 2). At that time, the general partners of Allen Co. were Herbert A. Allen and C. Robert Allen, III and the limited partners were various members of the Allen family and trusts for the benefit of the Allen family. (JA. 649-650) (Stips. 2 and 3).

Allen Inc. was formed in 1964 to take over the underwriting functions theretofore performed by Allen Co. (JA. 649) (Stip. 2). At all times relevant to this action, the general partners of Allen Co. and three of its limited partners (including the spouse of a limited partner) in the aggregate owned 50.5% of the Allen

Inc. shares, with the balance being owned by approximately 33 former employees of Allen Co. Substantially all of the non-Allen family shareholders were officers and/or employees of Allen Inc. or Allen Co. (JA. 649-650) (Stip. 3).

During all relevant periods, the Board of Directors of Allen Inc. was comprised of 15 persons, including Herbert Allen, C. Robert Allen, III and Herbert A. Allen. Herbert Allen, a former general partner of Allen Co. and the father of Herbert A. Allen, served as Chairman of the Board of Allen Inc.; and Herbert A. Allen served as the President of Allen Inc. (JA. 649, 651-652) (Stips. 2, 6 and 7).

Between the time of its formation and through the period of the Exchange Offer, Allen Inc. and Allen Co. maintained offices at the same business location and shared a common back office. The personnel in that back office performed services for both Allen Co. and Allen Inc. and for the most part were paid by Allen Co. From time to time, Allen Co. participated in investment opportunities brought to it by Allen Inc. (JA. 651) (Stip. 5); and Allen Co. made subordinated loans to Allen Inc. in order to finance the underwriting activities of Allen Inc., which loans were customarily repaid after the underwriting. (JA. 650) (Stip. 3). During the Exchange Offer, checks of certain soliciting dealers intended for Allen Inc. were made payable and sent to Allen Co. Such funds were routinely turned over to Allen Inc. (JA. 652) (Stip. 12). Allen Co. and Allen Inc. even had logos that were virtually the same:

ALLEN & COMPANY
INCORPORATED

ALLEN & COMPANY
Established 1922

The evidence is clear that Allen Co. and Allen Inc. were in essence one and the same person and that they intended to convey that appearance. Day even testified that he "never made any distinction between Allen & Co. and [Allen Inc.]." (JA. 116). There was a high degree of common ownership (50.5%). They shared chief operating officers as well as back office personnel; they also shared back offices. Furthermore, Allen Co. paid the salaries of shared personnel and put up the money necessary for Allen Inc. to engage in the underwriting business. Allen Co. had stepped aside to permit Allen Inc. to take over its underwriting personnel and underwriting business.

Although courts are generally reluctant to pierce the corporate veil without proof of a complete disregard of corporate form, this action involves securities dealers, raising other considerations.[30/] The manner in which Allen Inc. came into being and

30/ See Bangor Punta Operations, Inc. v. Bangor & Aroostook R.C., 94 S. Ct. 2578, 2584 (1974) in which the Court stated:

> "We are met with the argument, however, that since the present action is brought in the name of respondent corporations, we may not look behind the corporate entity to the true substance of the claims and the actual beneficiaries. The established law is to the contrary. Although a corporation and its shareholders are deemed separate entities for most purposes, the corporate form may be disregarded in the interests of justice where it is used to defeat an overriding public policy."

operated was clearly designed to confuse the investing public to believe that it was dealing with the old established firm of Allen Co. when it dealt with Allen Inc. Their use of the common personnel, common offices, common operating capital, similar names and similar logos were all designed to convey this impression.

The common law has long recognized that the use of similar business names can be an unfair or fraudulent practice. Accordingly, all states maintain lists of business entities organized and licensed to do business within their state and refuse to allow any other similar business to use a similar name without the express consent of the previously established firm. Thus, one business is prevented from trading on the name of another. See Taussig v. Wellington Fund, Inc., 187 F. Supp. 179 (D. Del. 1960).

Recognizing that section 10(b) prohibits all forms of deceptive practices in connection with the purchase on sale of securities, the SEC has similarly prohibited a broker dealer from operating a branch office under the designation of a "division of" that broker dealer, BWA, Inc. (SEC 1972) CCH Fed. Sec. L. Rep. ¶79,000. In so holding the Commission stated "the potential for misrepresentations of the branch office's function is great, especially since the branch is new and lacks a past history of operations." It has also been held to be misleading for a company to use a name which conveyed the impression that it was a securities exchange. SEC v. Los Angeles Trust Deed and Mortgage Exchange, 186 F. Supp. 830 (D.Cal.1960).

The use of the "Allen & Company" name by Allen Inc. was clearly designed to convey the impression that it, Allen, Inc., possessed the personnel and financial backing of Allen Co. There can be no better evidence of this fact than the statement of their own client that he did not make any distinction between the two (JA. 116) and the confusion of the broker dealers in the Exchange Offer syndicate who sent their checks to Allen Co. instead of Allen Inc. If their own clients and the members of their industry cannot distinguish them, the investing public should not be expected to do so. Here Allen Inc. sought to convey the impression that it was the same person as Allen Co. This in itself was a violation of section 10(b) and Allen Co. was a party to that violation.

Section 20(a) of the Securities Exchange Act, 15 U.S.C. §78t(a) provides another basis for finding Allen Co. liable in this case. It provides:

> "Every person, who directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

The partners of Allen Co., together with the members of their immediate families, owned a majority of the voting stock of Allen Inc. and served as the chief operating officers of Allen Inc. As such, they either controlled or had the power to control Allen Inc. Accordingly, Allen Co. under section 20(a) was responsible for the actions of Allen Inc. "unless it acted in good faith and did not directly or indirectly induce the illegal act or acts of Allen Inc." Because the acts of Allen Inc. were largely

performed through the person of Herbert A. Allen, one of the two general partners of Allen Co., such a claim can have no validity. 31/

31/ See Sanders v. John Nuveen & Co., Inc., CCH Fed. Sec. L. Rep. ¶95, 347 (7th Cir. 1975) in which a company placing its senior vice president on a three-man executive committee of an underwriter was held liable under Section 20(a).

CONCLUSION

The judgment of the District Court in favor of the defendants should be reversed and judgment should be entered in favor of plaintiff and the class.

Dated: New York, New York
December 9, 1975

Respectfully submitted,
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On the Brief

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

PATRICIA K. COLE, being duly sworn, deposes and says that she is in the employ of Milberg & Weiss, attorneys for the within named Plaintiff-Appellant herein, and is over the age of 21 years. That on the 9th day of December, 1975, she served two copies of the within BRIEF FOR PLAINTIFF-APPELLANT upon each of the attorneys for the respective parties named below, by depositing a true copy of the same to each of them, securely enclosed in postpaid wrappers in a post office box regularly maintained by the United States Government at One Pennsylvania Plaza, New York, New York, directed to each of them at their respective addresses set forth below, those being the addresses within the State designated by them for that purpose on the preceding papers in this action, or the places where they then kept their respective offices between which places there then was and now is a regular communication by mail:

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Patricia K Cole

Sworn to before me this
9th day of December, 1975.

Linda S. Baker
Notary Public

LINDA S. BAKER
Notary Public, State of New York
No. 43-4613498
Qualified in Richmond County
Commission Expires March 30, 1977